

Number: **201119022**
Release Date: 5/13/2011
Index Number: 1362.04-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact: _____, ID No. _____

Telephone Number:

Refer Reply To:
CC:PSI:03
PLR-143089-10
Date:
January 26, 2011

X =

State =

IRA1 =IRA2 =
$$\underline{A} =$$
Date =

1
Date =

2
Date =

3
Date =

4
Date =

5
Date =

6

Dear _____ :

This letter responds to your letter dated June 8, 2010, and subsequent correspondence, submitted on behalf of X, requesting a ruling under § 1362(f) of the Internal Revenue Code.

FACTS

X incorporated under the laws of State on Date 1 and elected to be an S corporation, effective Date 2. In a series of sales, the first of which occurred on Date 3, X sold shares to IRA1 and IRA2, both of which are ineligible shareholders under § 1361(b)(1)(B). The period of limitations on assessments under § 6501(a) has expired for all taxable years beginning before Date 4. However, the period of limitations under § 6501(a) has not expired for the taxable year beginning on Date 4, or any subsequent taxable years.

On or about Date 5, X learned that its S corporation election had terminated on Date 3 when IRA1 and IRA2 became shareholders of X. Subsequently, on Date 6, IRA1 and IRA2 transferred all of their shares of X stock to A, an eligible shareholder under § 1361(b)(1)(B). X represents that A always reported the full amount of income and losses both for the shares that he owned in his individual capacity, and for the shares IRA1 and IRA2 owned between Date 3 and Date 6.

X represents that the termination of its S corporation election was inadvertent because neither X's shareholders nor the attorney who facilitated IRA1's and IRA2's stock purchases were aware that an IRA was an ineligible shareholder. Furthermore, X and its shareholders agree to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary with respect to the period specified by § 1362(f).

LAW AND ANALYSIS

Section 1361(b)(1)(B) provides that, for purposes of subchapter S, the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not, among other requirements, have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Rev. Rul. 92-73, 1992-2 C.B. 224, provides that a trust that qualifies as an IRA under § 408(a) is not a permitted shareholder of an S corporation under § 1361. In addition, Rev. Rul. 92-73 notes that, when an S corporation inadvertently terminates due to the transfer of S stock to an IRA, relief may be requested pursuant to § 1362(f).

Section 1362(d)(2)(A) provides that an election under § 1362(a) is terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(d)(2)(B) provides that any termination under § 1362(d)(2)(A) is effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in the termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in the termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the termination occurred, and each person who was a shareholder in the corporation at any time during the period specified pursuant to § 1362(f), agree to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to this period, then, notwithstanding the circumstances resulting in the termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(b) of the Income Tax Regulations provides that the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the event took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event, tends to establish that the termination was inadvertent.

Section 1.1362-4(d) provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner. In the case of a transfer of stock to an ineligible shareholder that causes an inadvertent termination under § 1362(f), the Commissioner may require the ineligible shareholder to be treated as a shareholder of an S corporation during the period the ineligible shareholder actually held stock in the corporation. Moreover, the Commissioner may require protective adjustments that prevent any loss of revenue due to a transfer of stock to an ineligible shareholder (e.g. a transfer to a nonresident alien).

CONCLUSION

Based solely on the information submitted and representations made, we conclude that X's S corporation election terminated on Date 3 when IRA1 and IRA2, both ineligible S corporation shareholders under § 1361(b)(1)(B), acquired stock in X. We also conclude that the termination was inadvertent within the meaning of § 1362(f). Consequently, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 4, and thereafter, provided that X's S corporation election was valid and was not otherwise terminated.

As a condition for this ruling, for the tax periods beginning on or after Date 4 in which X reported a net loss, all relevant parties must, for tax purposes, treat IRA1 and IRA2 as the shareholders of the shares of stock they owned between Date 4 and Date 6. For the tax periods beginning on or after Date 4 in which X reported a net gain, all relevant parties must, for tax purposes, treat A as the shareholder of the shares of stock IRA1 and IRA2 owned between Date 4 and Date 6. All of X's shareholders in determining their respective income tax liabilities during the termination period and thereafter, must include their pro rata share of the separately computed items of income (including tax-exempt income), loss, deduction, or credit and non-separately computed items of income or loss of X as provided in § 1366, make any adjustments to basis provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat X as described above, this ruling will be null and void.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

We direct this ruling only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, we are sending a copy of this letter to your authorized representative.

We based the rulings contained in this letter upon information and representations the taxpayer submitted, along with a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

James A. Quinn
Senior Counsel, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes